

Annual Reform Recommendations from the Government of the United States to the Government of Japan under the U.S.-Japan Regulatory Reform and Competition Policy Initiative

December 7, 2005

Launched by President George Bush and Prime Minister Junichiro Koizumi in 2001 under the U.S.-Japan Economic Partnership for Growth, the Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative) promotes economic growth and open markets by focusing on sectoral and cross-sectoral issues related to regulatory reform and competition policy. Now in its fifth year, the Initiative continues to play a central role to further strengthen trade and economic relations between the United States and Japan.

The United States welcomes Prime Minister Koizumi's continued efforts to reform the Japanese economy, which have helped put Japan on a growth trajectory and created greater opportunities for trade and investment. The United States also welcomes the good work of both the Council for the Promotion of Regulatory Reform and the Headquarters for Promotion of Special Zones for Structural Reform, which have been strong and effective advocates of regulatory and structural reform.

The recommendations included in this year's submission place an emphasis on reform measures in key sectors and cross-cutting areas and are intended to support economic growth and further open markets in Japan. In addition, the United States continues to make a special effort to focus on issues Prime Minister Koizumi and his Administration have identified as important areas for reform, such as telecommunications, information technologies, intellectual property rights, medical, agriculture, privatization, and competition policy.

The United States is providing the proposals included in the Summary of Recommendations and the Annex to the Government of Japan to serve as the basis for discussions over the coming months in the High-Level Officials Group and the Working Groups established under the Regulatory Reform Initiative. These Groups will in turn develop a fifth annual report to the President and Prime Minister specifying the progress made under this Initiative, including reform measures to be taken by each Government.

During the first four years of this Initiative, private-sector representatives periodically joined the Working Groups to provide valuable expertise, observations, and recommendations on a wide range of issues. The United States looks forward to working with Japan in the coming months to continue to integrate the private sector in this Initiative.

The Government of the United States is pleased to present these reform recommendations to the Japanese Government and looks forward to receiving Japan's reform proposals to the United States.

TELECOMMUNICATIONS

Japanese consumers continue to adopt advanced telecommunications technologies and services at a rapid pace. In 2005, Japan had over 20 million subscribers for broadband Internet access by the end of June and 37 million third-generation (3G) mobile phone subscribers by the end of August. In addition, the Ministry of Internal Affairs and Communications (MIC) registered 10 million Voice Over Internet Protocol (VOIP) subscribers by the end of September this year. In particular, the United States commends Japan for stimulating competition in the oligopolistic mobile phone market by providing spectrum licenses to three new market entrants, who are expected to begin services in 2006. The new licenses bring opportunities for U.S. investment and equipment in Japan's growing telecom market, and new market entrants promise to ease the high mobile per-minute charges for Japanese consumers.

The United States, however, cautions Japan to ensure a competitive environment for the new market entrants as they deploy the necessary mobile network infrastructure. Furthermore, competition policy in the wireline voice market, which is shifting from analog-based communications to Internet Protocol, must continue to encourage innovation while balancing the market dynamics between the dominant carriers owned by NTT and the competitive carriers. Though recognizing the enormous progress made by regulatory reform over the past five years, the United States urges MIC not to allow NTT to undermine the safeguards that established intra-company competition in 1999.

Building on the progress achieved in the previous year, the United States also suggests that the Telecommunications Working Group continue to invite experts from government and the private sector to provide their perspectives on new and mutually important technology issues.

SUMMARY OF RECOMMENDATIONS

- **Regulatory Independence:** Take steps to transfer regulatory functions to an independent agency not under ministerial authority, and eliminate legal requirements for the government to own shares of NTT.
- **Mobile Termination Rates:** Investigate if rates for termination to dominant mobile carrier networks are set at reasonable, competitive levels, and ensure competitive neutrality in retail rate setting.
- **Transparency and Technology Choice:** Increase public participation in MIC's regulatory and policy decisions, and institute a clear policy of technology-neutral spectrum licensing.
- **Spectrum Policy:** Ensure that Japan's spectrum management policies and practices (such as licensing, allocation, testing, and fees) are more transparently administered, promote greater innovation, competition, and efficient spectrum use (in both the licensed and license-exempt areas), and adhere to technology-neutral principles.
- **Maintaining Competition Safeguards:** Prevent abuses by carriers with market power as technologies and services move towards "convergence."
- **Equipment Certification:** Conclude a Mutual Recognition Agreement between the United States and Japan that would facilitate more efficient trade in telecommunications products, and streamline Suppliers' Declaration of Conformity procedures.
- **Wireline Interconnection:** Require separate cost-oriented rates for NTT East and West, eliminate the cross-subsidy of interconnection revenue, and ensure competitive neutrality in the use of the universal service fund.

TELECOMMUNICATIONS

I. Promoting Regulatory Independence, Transparency, and Technology

Neutrality/Choice. The Ministry of Internal Affairs and Communications (MIC), which combines regulatory oversight and policy promotion for the telecom sector, has long had difficulty shielding the regulatory decision-making process from partisan influences. By developing and implementing policies in a more transparent manner and adhering to the principle of technological neutrality in this regard, MIC will lessen the perception that its decisions provide disproportionate benefits to larger companies with historical ties to the government – at the expense of new entrants.

A. To foster regulatory independence, the United States urges Japan to:

1. Develop a plan for moving regulatory functions from the purview of a ministerial agency subject to direct political control to a fully independent governmental organization; and
2. Eliminate any requirements that the Japanese Government own a specified amount of NTT shares and that foreign shareholding or a management role in NTT be restricted.

B. To foster greater transparency in policymaking and revision of telecommunications regulations, the United States urges MIC to:

1. Open the selection process for Government-sponsored study groups such that any interested stakeholder, foreign or domestic, is given the opportunity to participate;
2. Ensure that all public comment periods are a minimum of 30 days; and
3. Provide interested parties with opportunities to comment on or reply to the public comments that have been submitted before the policies or regulations are finalized.

C. To ensure that service providers can introduce innovative technologies, the United States urges Japan to:

1. Institute a clear policy of technology neutral licensing, separating, to the maximum extent possible, operator choice of technology from the spectrum assignment and service license process; and
2. Ensure that it will not unduly promote, mandate, or favor specific technologies such as those developed through cooperative agreements with other countries.

II. Strengthening Competitive Safeguards on Dominant Carriers. In 2001, Japan established a framework for “asymmetrical regulation,” with stricter requirements on designated dominant carriers that control bottleneck facilities. In 2004, MIC further deregulated competitive carriers by abolishing the Type I/II classification system. However, as telecom services migrate to IP (Internet Protocol)-based networks and “convergence” becomes a reality, MIC should resist attempts to rollback the requirements on dominant carriers. The United States recommends that Japan continue to secure a competitive environment for the telecom sector that does not hinder new market entrants, competitive carriers, and foreign equipment suppliers.

A. Dominant Carrier Regulation and Competition Safeguards. As part of the competition policy review that MIC began in October 2005, the United States urges Japan to respond to changing market conditions by:

1. Maintaining structural separation in the NTT Group company, to ensure that the NTT group does not exploit wireline/wireless convergence to undermine competition;
2. Ensuring that proposals to relax dominant carrier requirements adhere to objective benchmarks for evaluating the state of competition in the telecom sector;
3. Developing policies that promote cross-platform competition for telecom/broadcasting convergence on IP-based networks; and
4. Conducting an open forum on NTT’s reorganization plan, taking into due consideration the principle of promoting intra-company competition as enshrined in the 1999 revision to the NTT Law.

B. Procurement. The United States urges Japan to continue ensuring fair procurement by dominant carriers such as the NTT regional companies by:

1. Providing a period for public comment on the appropriateness of renewing obligations under the U.S.-Japan Network Channel Terminating Equipment (NCTE) Agreement as modified in the Third Report to the Leaders;
2. Examining NTT’s current system of limiting participation at earlier stages of development and commercial trials of new technologies, if large-scale deployment of standardized technologies is expected;
3. Ensuring that any MIC policy recommendations for technical requirements for next-generation infrastructure are subject to an open and transparent process; and

4. Opening procurement by the Japanese Government of telecommunications services, including VOIP, to any supplier, including foreign operators, on a non-discriminatory basis.
- C. Wireline Interconnection. Keeping in mind that the current LRIC model will expire in 2008, and to ensure a competitive playing field under changing market conditions, the United States urges Japan to:
1. Require NTT East and West to each set a cost-oriented interconnection rate, consistent with Japan's WTO obligations, taking into account differing costs of the respective regions; and, as necessary, permit differential interconnection rates between the regional carriers, taking into account dangers of (and methods to prevent) anti-competitive price squeezes;
 2. Consider transitioning to a bill-and-keep cost-recovery mechanism for the broadest possible range of network access functions offered by NTT; and
 3. Eliminate the use of interconnection revenue as a source of cross-subsidization between NTT East and West, based on the activation of the revised universal service fund mechanism.
- D. Universal Service. The United States urges Japan to ensure that the universal service program is implemented in a competitively-neutral manner that gives all eligible operators meaningful opportunities to access funding, and does not simply result in further strengthening NTT's dominance of local service.

III. Promoting Competition in the Mobile Sector and the Efficient Use of Spectrum.

Consistent with Japan's vision of a "ubiquitous network society," the United States recommends that Japan increase flexibility and transparency in its spectrum policy, and apply principles of network and competition policy to the mobile sector.

- A. Mobile Termination Rates. Keeping in mind that Japan has committed, in its Telecommunications Business Law as well as in the 2002 Regulatory Reform Initiative's Report to the Leaders, to ensuring competitive interconnection rates for dominant wireless networks, the United States urges Japan to:
1. Institute an objective and transparent means for evaluating whether mobile wireless termination rates are set at levels that reflect the principle of cost-orientation under efficient management, and to provide a clear basis for arbitration if commercial negotiations fail;
 2. Institute competitive neutrality for wireline carriers seeking to interconnect with mobile operators by eliminating the default right of mobile carriers setting the retail rate; and

3. Analyze NTT DoCoMo's dominant position in the mobile sector and the degree to which existing mobile carriers exert oligopolistic market power in the sub market for call termination.
- B. New Market Entrants. With Japan's licensing of three new market entrants for the 1.7GHz and 2GHz bands, as well as additional opportunities through leasing, the United States urges Japan to take strong significant steps to ensure a level playing field for the new companies, including addressing such issues as:
1. Facilitating roaming on incumbent networks for reasonable rates;
 2. Ensuring sufficient access to towers and tower sites;
 3. Analyzing incumbents' unused spectrum, determining criteria to identify "warehousing" (hoarding), and taking steps to eliminate it; and
 4. Facilitating the ability of licensed operators to lease, sub-lease, and exchange spectrum with other service providers, by creating a secondary market.
- C. Spectrum Allocation For New Technology. The United States urges Japan to:
1. Begin a public process of identifying, allocating, and setting proposed assignment dates, as soon as possible, for spectrum that can be used for innovative wireless LAN (Local Area Network) technologies, fixed and mobile MAN (Metropolitan Area Network) services and other non-standardized technologies;
 2. Consider, where feasible, making spectrum available for such technologies on an unlicensed consumer usage or "license-exempt" basis;
 3. Refrain from instituting privileged spectrum rights exclusively for preferred users (e.g., home-entertainment equipment makers) when shared use would be possible; and
 4. Review procedures for obtaining test licenses with a view to streamlining the process, making it more transparent, and establish procedural safeguards that prevent incumbent companies from hindering the testing of competing technologies.
- C. VOIP Over Mobile. The United States recommends that Japan take immediate steps to create a flexible regulatory framework for Internet Protocol-based mobile communications that allows both new and incumbent operators technology choice and ensures that the licensing process is timely, objective, and transparent.
- IV. Promoting Trade in Telecommunications Equipment.** The United States and Japan have already taken positive steps towards facilitating more efficient trade in

telecommunications products through mutual recognition of testing and certification requirements. Technology is evolving at a rapid pace, and it has become essential to reduce the “time-to-market” as much as possible to keep up with demand for advanced technologies and services. The United States recommends that Japan work towards streamlining its certification process for telecom equipment, to benefit both domestic and foreign equipment makers.

- A. MRA. The United States proposes that the Governments of the United States and Japan conclude a Mutual Recognition Agreement (MRA) for requirements relating to conformity assessment of telecommunications equipment so that the agreement will take effect by the end of CY2006.
- B. Review of Japan’s Conformity Assessment Requirements. With a view towards removing burdensome requirements that do not reflect the technological realities of the global marketplace, the United States recommends that Japan seek industry feedback in a transparent manner on its conformity assessment system, including:
 - 1. Updating the Suppliers’ Declaration of Conformity (SDoC) system, which was established in 2003, with particular attention to industry’s experience, to make SDoC an efficient and attractive alternative to third-party certification; and
 - 2. Adopting a “family approval” approach for radio type approval procedures that allows modifications to radio equipment certifications without requiring a new type approval registration.

- V. **Removing Regulatory Impediments to Advanced Technologies and Services.** The United States looks forward to enhancing the Telecommunications Working Group dialogue by inviting experts from government and the private sector as guest speakers to share their views on timely topics mutually agreed upon by both governments. In particular, the United States welcomes the opportunity to continue the regulatory challenges in both countries of introducing new technologies and services, such as Software Defined Radio (SDR) or Broadband Over Power Lines (BPL, also known as Power Line Communication or PLC).